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China: Activity and Tactics in US Commodity Markets

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An Intelligence Assessment

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EA 83-10096
June 1983

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China: Activity and Tactics in US Commodity Markets

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An Intelligence Assessment

This paper was prepared by [redacted]
[redacted] Office of East Asian Analysis. It was
coordinated with the National Intelligence
Council. [redacted]

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Comments and queries are welcome and may be
directed to the Chief, Domestic Policy Branch, OEA,
[redacted]

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**China: Activity and Tactics
in US Commodity Markets** ¹

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Key Judgments

*Information available
as of 1 June 1983
was used in this report.*

Over the last several months China increasingly has threatened to reduce or terminate purchases of US agricultural goods in reaction to perceived political or economic slights. China is capable of such a step, but we believe a number of factors will work to keep China in the US grain market:

- Increasing domestic demand for grain.
- A policy of diversifying sources of food imports.
- The realization that the United States is one of the largest and most dependable sources of grain.
- The generally lower price of US grain.
- Concern about disrupting trade of other goods.

We do expect major fluctuations in Chinese purchases of selected US commodities in the future. We believe, however, that these will be based primarily on US and foreign price and market conditions and on China's own harvests. We also expect the Chinese to continue to hint at economic retaliation and to give essentially economic decisions a political gloss, as they did last year when they reduced purchases of US soybeans and cotton.

Chinese activity in US commodity markets is governed by price more than any other factor. Credit terms and quality are secondary considerations, and, unlike the Soviet Union, China traditionally has placed less emphasis on personal trading relationships.

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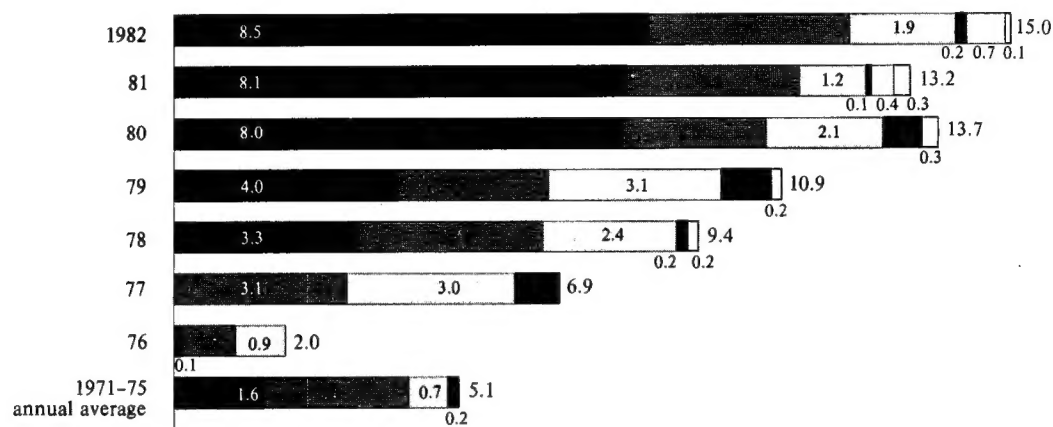
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Figure 1
China: Imports of Grain, by Source

Million tons

Legend

- United States
- Canada
- Australia
- Argentina
- France
- Other



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China: Activity and Tactics in US Commodity Markets

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US-China trade in agricultural goods has expanded rapidly since 1977. The United States is now China's principal source of agricultural commodities, particularly grain (see figure 1). And although China's imports of US commodities have dropped in the last two years, in 1982 Beijing still was our seventh-largest customer for farm products (see figure 2). Bilateral political difficulties have begun to affect this trade and raise questions about the long-term outlook for growth.

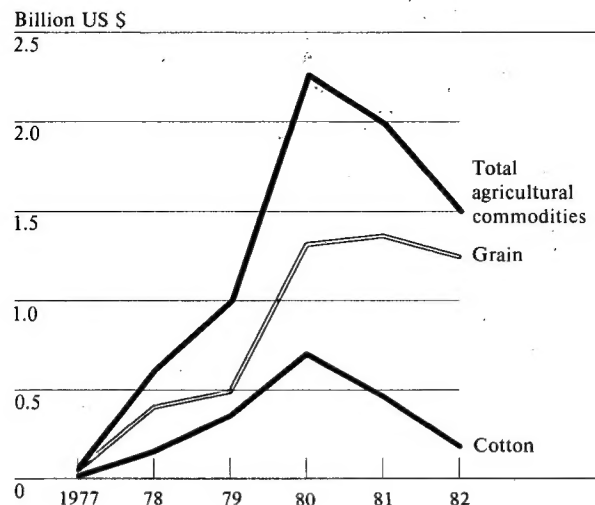
Factors Governing Chinese Activity

Price. Price more than any other factor determines where and when the Chinese enter world commodity markets. China generally places less emphasis on other factors—quality, politics, and personal relationships—than do other countries, most notably the Soviet Union. Figure 3 demonstrates the link between price and purchases in the United States. the emphasis on price occurs because Chinese Government supervisors give heavy weight to the prices paid in evaluating the performance of their representatives in the United States.

China generally has done better than other countries in securing lower prices, in part because it prefers to deal quietly through private firms—with which it can maximize its leverage. Unlike many other importing countries, China does not issue public tenders for grain, announcing the amount they intend to purchase. Beijing also typically disguises the total amount of its purchases by buying from several countries and firms, an attempt to reduce the impact of its activity on the international market. Record domestic harvests of many commodities in recent years have also given the Chinese the luxury of choosing when to enter international markets.

Although China generally buys from the country with the lowest price, it has also signed long-term supply agreements with five countries (see table 1) to minimize the potential effect on the market of a poor harvest or a politically motivated embargo.

Figure 2
China: Purchases of US
Agricultural Goods^a



^a Excluding forest products.

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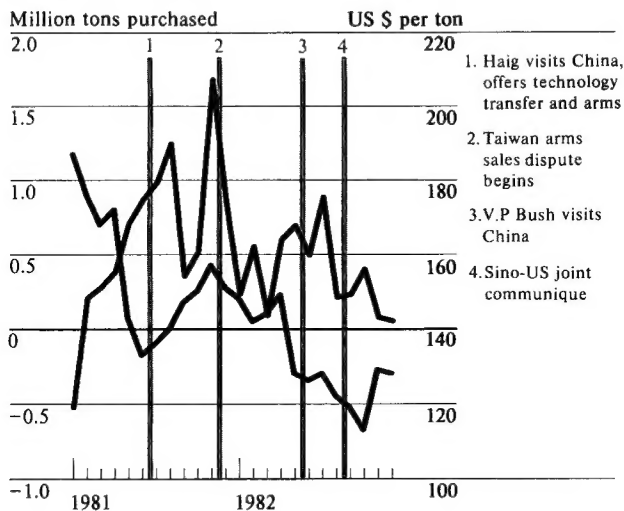
Financing. Favorable financing terms are a secondary consideration. China has traditionally received the most attractive financing on French grain marketed through the EC. The EC periodically gives a special subsidy for grains shipped to China, and France has allowed repayment to run as long as three years, instead of the usual 18 months or less. Nevertheless, even though purchases from France are up somewhat this year, the entire EC's share of the China market remains small.

The United States is the only major supplier that has not offered attractive repayment plans or reduced purchase prices to China. Although the Chinese have expressed some interest in US Commodity Credit Corporation and blended credit programs, Beijing has

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Figure 3
China: Purchases of US Wheat



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not seriously pursued US credits. We doubt China will do so as long as the buyer's market continues and China maintains large foreign exchange reserves.

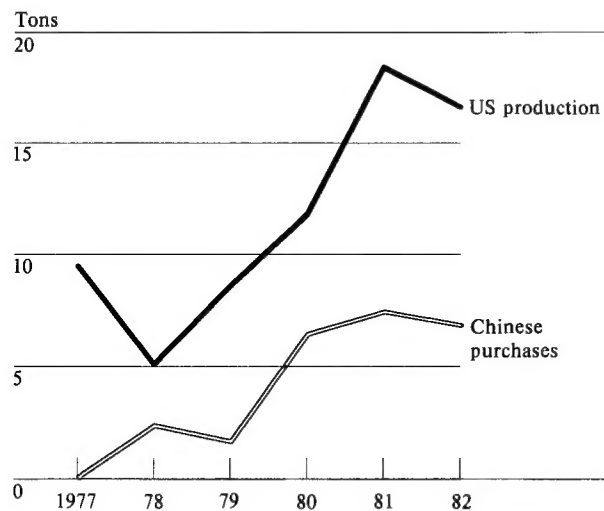
Quality. [redacted] grain quality is increasingly important in Chinese purchasing decisions, but we believe quality concerns remain secondary to price. The Chinese buy large amounts of US soft red winter wheat, although it is the lowest in quality, simply because it is also the cheapest. US farmers have expanded production of soft red winter wheat to meet Chinese demand. (See figure 4.)

The Chinese have been most concerned about quality in cases where disease could be spread to their own domestic crops. In 1981 they stopped buying Pacific Northwest white wheat because spores of wheat smut disease were found in the wheat.² China National

² *Tilletia controversa Kuhn* (TCK) wheat smut occurs in localized areas of several Pacific Northwest states. In years when climatic conditions are favorable for the spore's growth, wheat heads are filled with the spores of the disease, lowering both the yield of the wheat and the quality of the flour. The spore is not harmful to humans or livestock [redacted]

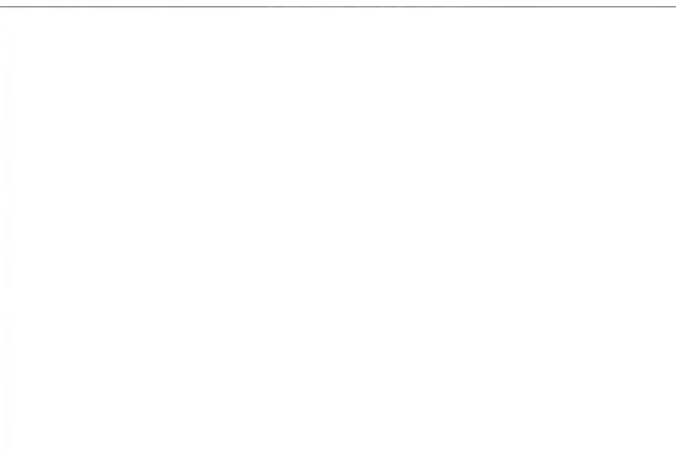
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Figure 4
China: Purchases of US Soft Red Winter Wheat



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Cereals, Oil, and Foodstuffs Import and Export Corporation (Ceroilfood), the organization responsible for grain purchases, had originally bought Pacific Northwest wheat because of its lower shipping costs and higher quality relative to soft red wheat. Officials in the Ministry of Agriculture's Bureau of Plant Protection have blocked further purchases for fear that TCK would infect China's own wheat crops. [redacted]



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Table 1
Long-Term Grain Agreements

	Annual Amount (million metric tons ^a)	Duration
Argentina	1.0 to 1.5	January 1981–December 1984
Australia	1.5 to 2.5	January 1982–December 1984
Canada	3.5 to 4.2	August 1982–July 1985
France	0.5 to 0.7	September 1980–May 1983
United States	6.0 to 8.0	January 1981–December 1984

^a China and the exporting country negotiate actual sales periodically during the agreement.

inactive in the futures market, are dependable in their contracting, and do not try to deceive US traders.

Use of the Futures Market

Importing countries seldom deal in the futures market, but China has speculated in futures as a way to reduce the cost of its eventual imports.

the Chinese have benefited from these transactions and that they will probably expand their use of futures for both speculation and hedging. China's futures contracting has largely been for hedging actual purchases, although some speculation has occurred.

The scale of Chinese activity in the futures market is difficult to establish because they often deal through front companies or have US trading companies make their purchases. the Chinese both buy and sell in the futures market to mask their physical purchases. The Chinese further obscure their activity by occasionally speculating on physical purchases and on the price spread between wheat and corn, for instance, by selling previous purchases of one grain to buy the other. By comparison, Soviet activity is much easier to follow, because generally they are

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Agricultural Futures Trading Floor, Chicago.

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Table 2
Production of Selected Agricultural Products

	Amount					Percent Change From Previous Year ^a Average Annual Increase				
	1957	1979	1980	1981	1982	1958-78	1979	1980	1981	1982
Grain (<i>million metric tons</i>) ^b	190.7	332.1	320.5	325.0	353.4	2.1	9.0	-3.5	1.4	8.7
Cotton (<i>million metric tons</i>)	1.6	2.2	2.7	3.0	3.6	1.3	1.8	22.7	9.6	21.3
Oil-bearing crops (<i>million metric tons</i>)	4.2	6.4	7.7	10.2	11.8	1.0	23.3	19.5	32.7	15.8
Sugarcane (<i>million metric tons</i>)	10.4	21.5	22.8	29.7	36.9	3.4	1.9	6.0	30.1	24.3
Sugar beets (<i>million metric tons</i>)	1.5	3.1	6.3	6.4	6.7	2.8	15.0	103.0	0.9	5.5
Jute, ambar hemp (<i>million metric tons</i>)	0.3	1.1	1.1	1.3	1.1	6.3	0.1	0.8	14.8	-15.9
Silk cocoons (<i>thousand metric tons</i>)	112.5	271.0	326.0	311.0	314.0	3.4	18.9	20.3	-4.6	1.0
Tea (<i>thousand metric tons</i>)	111.5	277.0	304.0	343.0	397.0	4.3	3.4	9.7	12.8	16.0
Aquatic products (<i>million metric tons</i>)	3.1	4.3	4.5	4.6	5.2	1.9	-7.5	4.5	2.4	11.9
Hogs (<i>million head at yearend</i>)	127.8	319.7	305.4	293.7	300.8	4.2	6.1	-4.5	-3.8	2.4
Sheep and goats (<i>million head at yearend</i>)	98.6	183.1	187.3	187.7	181.8	2.6	7.8	2.3	0.2	-3.2
Large animals (<i>million head at yearend</i>)	83.5	94.6	95.2	97.6	101.1	0.6	0.7	0.7	2.5	3.6
Gross value of agricultural out- put (<i>billion 1970 yuan</i>)	79.3	158.4	162.7	172.0	190.9	2.9	8.6	2.7	5.7	11.0

^a Based on unrounded numbers.^b Includes potatoes converted on a grain equivalent basis of 5 to 1.

Timber. China's purchases of US timber are made through China National Native Produce and Animal Byproducts Import and Export Corporation (China-tuhsu). Its US office is near Seattle.

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Table 3 *million dollars*
Imports of US Agricultural Commodities

	1978	1979	1980	1981	1982
Wheat	250	214	1,039	1,269	1,047
Corn	112	269	225	62	189
Soybeans	15	107	155	130	63
Soybean oil	26	36	56	17	0
Cotton	157	357	701	464	178
Timber and pulp	4	4	110	168	237
Other	13	8	34	14	28
Total	577	995	2,320	2,124	1,742

Cost of Tough Negotiating

China's tough negotiating tactics and market savvy have helped China become one of the world's leading commodity traders with a minimum of cash outlay, but not without hidden costs. In particular, the Chinese risk alienating potential business partners and reducing the competition for its markets. Because of the small profit margins involved in dealing with China, many smaller firms cannot afford to enter the China market. [redacted]

As political relations have cooled, however, the Chinese increasingly have begun to hint that future commodity purchases may be linked to broader economic and political considerations. For instance, Beijing tied its cutoff of soybeans and cotton purchases from the United States in early 1983 to the textile dispute, and hinted [redacted] that US technology transfers may also influence Chinese purchases. We are skeptical, however, about how large a role broader political considerations actually played in the soybean and cotton decision. The Chinese had previously reduced purchases of these commodities to insignificant levels for what appear to be purely economic reasons; China's production of these commodities had been high for three years running (see table 2). [redacted]

Political-Economic Linkage

Historically the Chinese have tried to keep their economic dealings separate from bilateral political issues, and changes in Sino-US relations have had little impact on Chinese purchases of US agricultural commodities. As figure 3 indicates, even during political tensions such as summer and fall 1981, Chinese purchases remained high. [redacted]

Another indication that the "bans" were based more on supply and demand and less on developments in the textile dispute came in the timber industry. During the textile dispute, the US press mentioned timber as one area likely to be hit in retaliation for US textile quotas. [redacted]

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[] Beijing's decisions have been consistent with economic needs; in the case of cotton and soybeans, China appears to have made political virtue out of an economic necessity. []

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China is certainly capable of reducing purchases of US agricultural goods for political reasons, but only at considerable economic and political cost. We believe a number of factors keep China in the US grain market:

- Increasing domestic demand for grain for both humans and livestock.
- Desire to avoid jeopardizing basic grain trading relationships, including the long-term grain agreement with the United States.
- The policy of diversifying sources of food imports.
- The realization that the United States is one of the few steady and reliable sources of grain for the future, especially for coarse grains.
- The generally lower price of US grain.
- Concern about further straining Sino-US relations and disrupting trade in other areas. []

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At the same time, if cost is roughly equivalent, we would expect the Chinese to purchase grain elsewhere when there are strains in bilateral relations. In any case, Beijing will continue to threaten economic retaliation and, as in the case of cotton and soybeans, give an essentially economic decision a political gloss. Conversely, with other grain-exporting countries expanding production, an improvement in Sino-US relations will not necessarily bring about an increase in the US market share. []

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We expect major fluctuations in Chinese purchases of selected US commodities, but we believe these will be primarily based on US and foreign prices and market conditions and China's own harvests. For instance, the recently concluded Sino-Soviet Trade Agreement calls for increased purchases of Soviet timber and may eventually restrict the opportunities for US timber sales to China. Changing markets may affect trade in other specialized commodities. Once again economic and not political considerations are likely to be paramount in Chinese thinking, and we judge the long-term outlook for Sino-US agricultural trade to be good. []

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